



EAGLE Training Program

Module 9 – Fraud Concepts

Learning Objectives

In this module, we will:

- Discuss what fraud is and who commits it
- Explain the importance of an awareness of the potential for fraud
- Identify the types of fraud and red flags associated with them
- Explain who is responsible for detecting fraud
- Identify controls for the prevention and detection of fraud

Fraud Defined

- **Fraud** “is an intentional act that results in a material misstatement in financial statements that are the subject of an audit.”
 - Statement on Auditing Standards (SAS) 99, *Consideration of Fraud in a Financial Statement Audit*
- Fraud vs. Error: The difference between sloppy accounting and fraud is **INTENT**.
 - What is known or should have been known

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Types of Fraud

- Misappropriation of Assets – theft or misuse of company assets
- Corruption – abusing influence and power within organization to obtain some benefit at organization’s expense
- Fraudulent Financial Reporting – intentional misstatements or omissions of amounts or disclosures in financial statements

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The Cost of Fraud

- It is estimated that fraud in the typical organization translates to 7% of annual revenue. In the U.S. this translates into \$994 BILLION in annual fraud losses.

Types Of Occupational Fraud & Abuse			
Category	Cases Reported	% of All Cases ¹	Median Loss
Asset Misappropriation	851	88.7%	\$ 150,000
Corruption	263	27.4%	\$ 375,000
Fraudulent Statements	99	10.3%	\$ 2,000,000

1. The sum of the percentages exceeds 100% because several of the cases involved schemes that fell into more than one category.

2. Source: Association of Certified Fraud Examiners 2008 Report to the Nation on Occupational Fraud and Abuse

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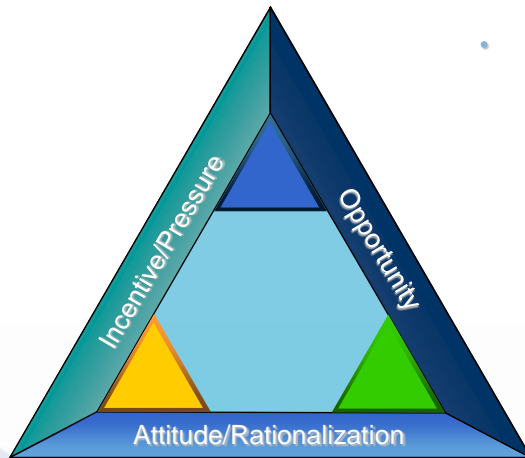
Who Commits Fraud?

- Management
 - Manipulation of the accounting records (Management fraud is fraudulent financial reporting.)
- Employee
 - Stealing the company's assets such as cash, inventory, etc. (Employee fraud is fraud perpetrated by employees against the organization.)

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The Fraud Triangle



- Three conditions typically present when fraud occurs:
 - Incentives or pressures on management
 - Opportunity exists (i.e., control weaknesses)
 - Ability to rationalize and/or justify the perpetration

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Who Commits Fraud and Why?

Fraud Scenario:

Employee: M. Smith

Position: Accounts receivable clerk

Responsibility: To apply cash receipts and to reconcile the bank accounts

Years With the Company: Eight years

Personal Status: Raising three children, one of whom has a medical condition her insurance does not fully cover.

Fraud Committed: Check kiting (taking advantage of the float in the bank account)

Bottom line: There is no “generic fraud profile”...

Anyone could be a suspect if he or she has the opportunity, pressure and attitude...

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Profile of the Fraudster

- Age – approximately 50% are 40+ years
 - 50's - median loss is \$500K (18.9% of cases)
 - Under 40 years old - median loss is less than \$145K
- Male 59% vs. Female 41%
- Above average education
- Executives vs. Employees
 - Employees 77% - median loss of \$70K for employees and \$150K for managers
 - Executives 23% - median loss above \$834K
- No criminal record
- Position of trust

Source: Association of Certified Fraud Examiners 2008 Report to the Nation on Occupational Fraud and Abuse



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Personal Red Flags

- Living beyond means
- Severe personal financial losses
- Addiction problems – drugs/alcohol/gambling
- Outside business interests
- Unusual secrecy
- Never takes vacation



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Examples that May Indicate Possibility of Fraud

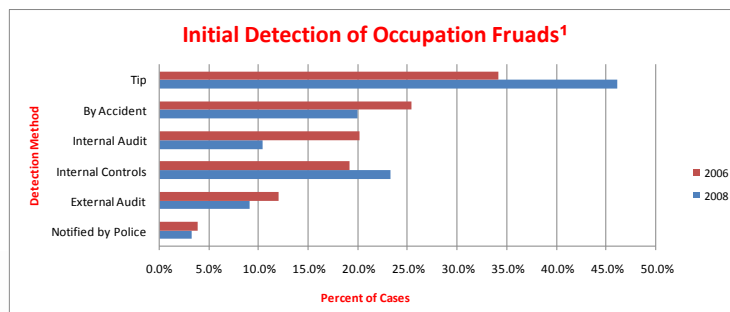
- Discrepancies in accounting records, including:
 - Transactions that are not recorded in a complete or timely manner or are improperly recorded as to amount, accounting period, classification or entity policy.
 - Unsupported or unauthorized balances or transactions.
 - Last-minute adjustments that significantly affect financial results.
- Conflicting or missing evidence, including:
 - Missing documents.
 - Documents that appear to have been altered.
 - Significant unexplained items on reconciliations.

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Allegations

How The Fraud Is Uncovered



Source: Association of Certified Fraud Examiners 2008 Report to the Nation on Occupational Fraud and Abuse

¹ The sum of percentages in this chart exceeds 100 percent because in some cases respondents identified more than one detection method.

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Examples of Types of Fraud Controls

- Prevent controls:
 - Access controls (IT)
 - Segregation of duties
- Detect controls:
 - Post-close journal entry review and approval
 - Automatic posting of sub-ledger to general ledger (IT)

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Fraud Awareness

- Management and Employees
- Internal Audit
- External Audit
- OSC Code of Professional Ethics
 - *“All government accounting professionals (employees and contractors working for the State of North Carolina) are enjoined to adhere to legal, moral, and professional standards of conduct in the fulfillment of their professional responsibilities.”*

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Your Responsibilities— Communication Requirements

- Document all issues that may indicate fraud
- All issues should be elevated to appropriate level of management
- Resources if you suspect potential fraud:
 - Contact Human Resources
 - Discuss with Supervisor
 - Office of the State Auditor Hotline



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Summary

- In this module, we:
 - Discussed the potential for fraud and explained why people may commit fraud
 - Identified sources of information to identify fraud risks
 - Identified controls for the prevention and detection of fraud
 - Explained your responsibilities in communicating possible fraud at your agency

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